RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Oct. 7, 1998 **LETTER 1262**

Sept. 25 DJIA 8028.77; PTI 5282; A-D Ratio +4.28
Oct. 2 DJIA 7784.69; PTI 5278; A-D Ratio +3.89
Dow Yield: 1.92%; Dow Price/Earnings: 19.7
Dow 144-day MA: 8046; Dow 34-day MA: 8443
Dow Times Book Value: 4.88; PTI 89-day MA: 5301
Percentage of Undervalued Blue-chips: 5%
Gold 34-day MA: 293

BAIL ME OUT: Bail out Mexico, bail out Asia, bail out Russia, and hey, we better bail out Brazil -- but what's this? Bail out a hedge fund to the tune of $3.5 billion? All this bailing might work in a bull market, but it's not going to work in a bear market. **Russell Prediction:** The word "bailout" is going to end up a dirty word or an oxymoron. In short, you can't bail the pain out of a bear market. No, the primary bear market is fated to run to conclusion, and all those billions of bailout dollars will end up as so much money down the drain.

What? We've just seen new record highs in the Utility Average and new record highs in the long Treasury bond. That combination has almost always been a powerful bullish force on the market. But not now. At the same time, the Transports have been diverging (declining) when the Dow advanced. This divergence represents bearish price action on the part of the Averages. **Russell Comment:** I take the Utility/bond strength as part of a stampede to **safety.** At the same time, I take the **fading Transports** (along with the sinking Dow) to be telling us, "Rotten business ahead, and probably a recession next year." As I see it, the sliding Transports and Dow plus the poor breadth are exerting a **powerful bearish force** -- a force considerably stronger than the normally bullish power of rising bonds and Utilities.

SENTIMENT: I continue to sense a built-in, persistent, bullishness in the stock market that may last for a few more months. I ascribe this to two phenomena: **(1)** Human nature is normally bullish, constructive, optimistic. People "want to believe." **(2)** The transition from optimism (bull market) to pessimism (bear market) does not take place overnight. Investors don't turn bearish just because the market is down for a few months. In a real primary bear market, it often takes many months, sometimes as much as a year (with many losses in many stocks) before sentiment turns dead bearish. We're far from that kind of sentiment now. At present we're still in the area where investors are thinking in terms of which stocks look "cheap" and which stocks to buy, buy, buy.

PRICE ACTION: We had an upside correction (Sept. 1 to Sept. 23), a correction that recouped roughly one-third of the Dow's July-August losses. The majority of stocks, as indicated by the sluggish action of the advance-decline ratio, did not do that well on the rally. Of particular interest was the **divergence** in the Transportation Average (see page 1 chart). Remember, the Transports failed to confirm when the Dow rallied to record highs in July. In September the Transports diverged again (see page 1 chart). Keep your eye on the Transports, they've been excellent bellwethers so far in this bear market. And they're looking very sick now.

All in all, however, don't expect the bear to have an easy time of it. He'll have a struggle all the way. Expect the Fed to fight the bear tooth and nail. Expect the IMF and the World Bank and the world's bankers to fight the bear. Expect CNBC and Fortune and Forbes to fight the bear. There'll be consortiums and bailouts and encouraging words and presidential promises -- but in the end the bear will have his way.

We might remember Russell's two bear market aphorisms: **(1)** In a bear market whatever can go wrong -- will go wrong. And **(2)** In a bear market values deteriorate **through time.**

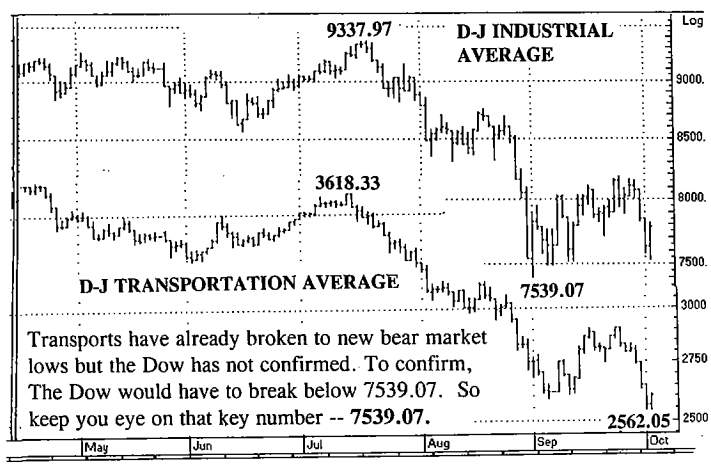
Bear Market Corrections: How far can a bear market rally carry? There's no definite formula for this, but most bear rallies tend to recoup one-third to two-thirds of the previous losses. As the Dow lost 1798 points between July 17 and August 31, a one-third recovery would entail the Dow advancing to around 8140. A two-thirds recovery would entail the Dow advancing to 8737. On September 23 the upward correction carried the Dow to a closing of 8154.41, very slightly better than a one-third correction.

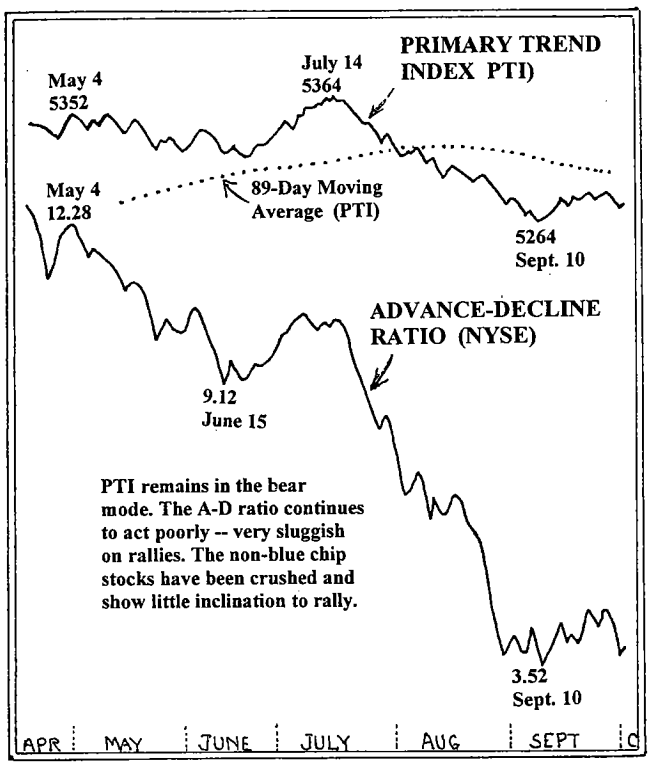
While the main mass of stocks has been sluggish and resistant to rally, that has not been the case with the big blue-chips. Proof -- the **BBI, my Big-Money Breadth Index**, has stubbornly resisted the decline. The BBI is an advance-decline index of the 10 largest-cap stocks in the S&P 500.

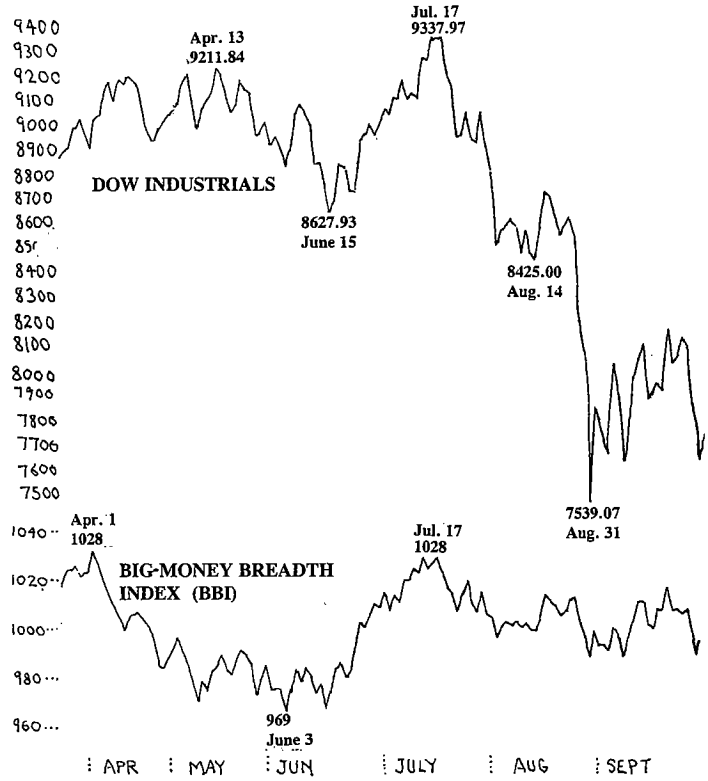
As you know, it's the big blue-chip stocks that have been the stars of this market. And the fact is that the stars, as a group, did not fall apart or crash on the big decline to the August 31 low. You can see this clearly on the BBI chart located on page 2. I've written that until the BBI breaks to new lows, the bear market will remain in its early or "polite" phase. This is where I believe we are now.

Remember, the Dow itself is composed entirely of big blue-chip stocks. As for the S&P 500, half of its value is made up of the 30 D-J Industrials (all 30 Dow Industrials are included in the S&P). Add another 25 big stocks and you realize that the S&P is also a reflection of the action of big blue-chip stocks.

So as far as market action over the last six months is concerned, I would have to say that the advance-decline ratio has been a much better indicator of what the broad market has been doing than either the Dow or the S&P. Let me put it another way -- if you're wondering why your portfolio or your mutual funds are still in the dumps despite the recent rally, it's because your investments have been doing what the general market has been doing.





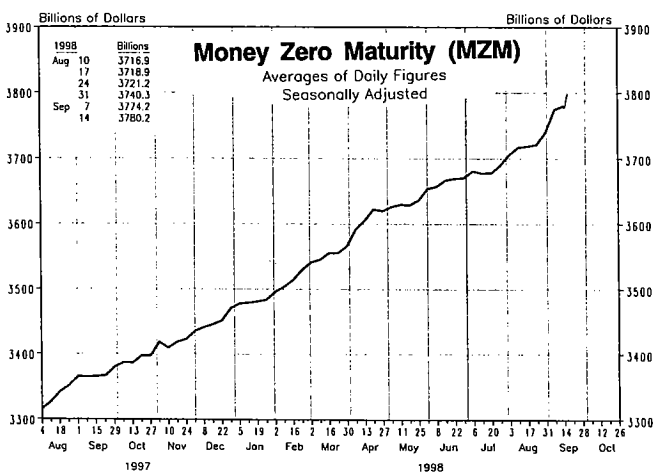


MONETARY INFLATION: Older subscribers remember back in the 1980s when Wall Street was obsessed with the weekly money supply figures. Every Friday, immediately after the close, traders would rush to their Reuters machine to get the latest report on the money supply. Today, money supply figures are largely ignored by both the investment fraternity and the public.

But the money supply figures are not being ignored at this office. And I don't think they are being ignored by the Fed. In fact, I believe that this chart is the reason that the Fed has been so reluctant to lower interest rates. Here we see a chart of the MZM money supply. MZM is the money of zero maturity, money that is immediately available to spend. MZM has fast become the favored indicator for those few economists and analysts who still monitor the money supply.

This chart is put out by the St. Louis Fed. The St. Louis Fed has, for many years, been the "keeper of the money supply statistics," and they have recently added MZM to their bi-weekly chart book. MZM is now rising at a furious rate. Over the last six months, MZM has risen by a rate of just over 12%.

On top of the surging money supply, gold has been creeping up. Rising money, rising gold, it's enough to give a Fed Chairman



nightmares. But the pressure was on and on September 29 the Fed finally dropped the Fed Funds rate by 0.25%.

One accepted definition of inflation is a **major increase in the money supply.** On that basis, the US is most definitely in the process of inflating. In fact, I believe this explosion in the money supply is the major force that is pitted against the bear market.

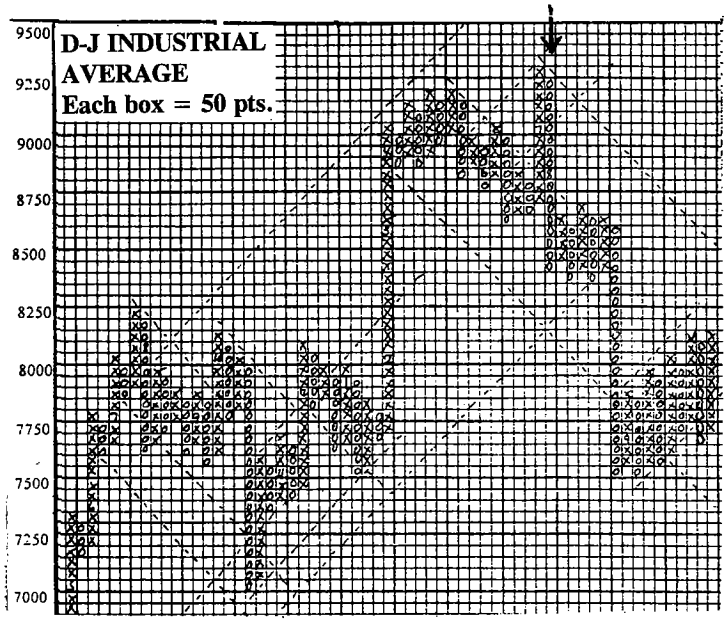
Two Russell Comments: (1) I believe the Fed is allowing this explosion in the money supply to continue because they feel the US is now in the position of being central banker to the world. The Fed also knows that the US is the world's only major buyers' market. And if the US is to continue to buy a huge portion of the world's goods, **it's got to have the cash.**

(2) As subscribers know, I've been advocating buying the long Treasury bonds, been advising buying them all year. But recently I've advised subscribers to ease up on their bond buying. My reason aside from the price action -- **the surging money supply and its inflationary implications.**

THE "COUNT" -- Question: Russell, in the last Letter you wrote that the first decline from a top formation in a stock average gives us a theoretical downside target or "count." In view of that, what's the count for the Dow?

Answer: I show on the third page a 3 x 50 point & figure chart of the Dow. The 3 x 50 means that each box on the chart equals 50 Dow points and only rallies or declines of three boxes or more (three boxes = 150 Dow points) are shown on the chart.

Point & figure is concerned with price only -- time is ignored. P&F philosophy holds that **price takes everything into account,** including time. Thus, a P&F chart presents a concentrated picture of price action. On the chart we see a top formation in the Dow in which the Dow whips back and forth between 9300 at the high and 8650 at the low. Then we see the big downside plunge, taking the Dow from 9300 down to 8450 (the plunge is marked with an arrow). The plunge represents a decline of 850 points on the P&F chart.

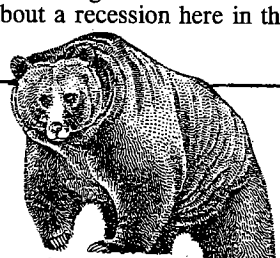


Since this is a three-box reversal chart, we multiply the 850 decline points by 3, giving us a total of 2550 points. We then subtract 2550 from the high of 9300 and we get a target price of **6750.** This is the downside count or **longer-term downside target for the Dow,** at least according to the P&F count technique. Remember, the long-term count does not preclude intervening upside corrections. The long-term count implies that this is where the Dow is ultimately heading.

Based on the chart, the Dow is now in a broad consolidation pattern. For a resumption of the bear market the Dow would have to decline to the 7500 box. A decline to Dow 7500 would be ominously bearish and would probably trigger another major bear leg -- to substantially below Dow 7000.

Note: This is the P&F system put forth by *Chartcraft* of New Rochelle, NY. I've used this system for years, and although it doesn't always work (nothing in this business always works) it's well worth following. By the way, downside counts are most reliable in bear markets, while upside counts work best during bull markets.

Consumers: The sale of existing homes dropped 4.7% in August. In September the Conference Board's Consumer Confidence Index dropped for the third month in a row. Last week *Investor's Business Daily's* indices of department-store stocks and apparel retailer stocks both sank to 52-week lows. Consumers' buying constitutes two/thirds of the Gross Domestic Product. With consumers finally pulling in their horns and a bear market in progress, it looks increasingly to me as though 1999 will be a recession year. I'm not talking about a recession in Russia or Malaysia, I'm talking about a recession here in the US.



INVESTMENT POSITION: The bear is in the box. The best place for us to be -- Treasury paper, bills, notes, bonds. Haven't I mentioned that before?

"But we can make money on rallies." Right, sure you can, but tell it to investors in Long Term Capital Management. Their investors made 40% two years in a row, but in this year of the bear the fund got murdered. What happened? The fund made a bet that by buying emerging market debt and shorting T-bonds they could make a killing. The odds were maybe 500 to one that this strategy would work. But bond-buyers rushed to quality, shocking the two Nobel Laureates plus other worthies on the board. The markets defied the odds as illiquid emerging market debt actually sank in the face of the Treasury rally. Result: the hedge fund was trapped, and it unraveled, as its losses ran into billions of dollars. The losses were so huge that the Fed decided (with many banks on the hook) that the fund was too big to fail; a consortium put up $3.5 billion to stave off a further disaster, and the situation is still being sorted out.

Conclusion: Stay safe, forget about beating the bear, just relax and watch the show. Remember, we're still in the "polite" phase of the bear market. Investors are still basically bullish and hoping, still obsessed with buying, not selling. The Dow backed off 19% and the analysts think they're seeing bargains. The price/earnings ratio for the S&P is currently 26.8. Bargains? Er, uh, not quite yet.

By the way, did you notice that the yield on the long Treasury bond dropped below 5% on September 30? Subscribers who bought the bonds (as recommended) should be smiling by now. I'm really embarrassed to say this but I know from experience that an investor is never happier than when he's making money in a bear market -- while his big-mouth neighbor next door is getting killed. That's just human nature, forgive me.

MAKING MONEY: The most important (and certainly the most popular) two pieces I've written in 40 years of publishing these Letters are **"Compounding"** and **"Rich Man, Poor Man."** I've had dozens of requests for these two pieces from business organizations, churches, investment advisors, even banks and brokerage houses. I last ran these articles in mid-1996, but since then I've gained hundreds of new subscribers who haven't seen these pieces. Furthermore, I've added a few items to these articles. So let's call the following pages, "Investment survival in a very tough world," or "What Richard Russell has learned about investing over the last 50 years."

THE PLAN: Here in late-1998 I continue to be flooded with advertisements and flyers telling me "how I can make a killing in the stock market." Every other magazine features stories telling me which stocks to buy. Newspapers, TV and radio feature "the best mutual funds to accumulate" and which funds I can "retire on." It's a veritable blizzard of information, some good, some so-so, most worthless.

Actually, I shouldn't ridicule these ads and mailings and info-mercials. The fact is that many of them are cleverly written and even fascinating to read. But I have to wonder whether they are of any use to the average investor. And I ask myself, "How many of the writers and advisors and publicity men who wrote these pieces have ever made any 'real money' for themselves?" My answer is, "Not many." And I know that for a fact because over the last 40 years I've known a lot of the people who write this stuff.

Making money in investing entails a lot more than predicting which way the stock or bond markets are heading or figuring out which stock or fund will double over the next few years. For the great majority of investors, making money requires a **plan, self-discipline** and **desire.** I say "for the great majority of investors" because if you're a Steven Spielberg or a Bill Gates you don't have to know about the Dow or the markets or about yields or price/earnings ratios. You're a phenomenon in your own field, and you're going to make big money simply as a by-product of your talent and ability. But that kind of genius is rare, very rare.

As for the average investor (you and I), unfortunately, we're not geniuses (at least I don't think we are) -- so **we must have a financial plan.** In view of this, I offer below a few items (I call them rules) that we must be aware of if we are serious about making serious money.

Rule 1: Compounding: One of the most important considerations for living in the modern world is that to survive

you must have money. But to live happily, you must have love, health (mental and physical), freedom and intellectual stimulation -- and yes, money. In teaching my own kids about money, the first thing I emphasized was a knowledge of the "money bible." What's the bible of money? Simple -- **it's a volume of the compounding interest tables** (available at any large bookstore). I wanted my kids to realize what happens to capital when it is compounded at various rates. The reaction to what the tables show is always -- surprise.

Compounding is the royal road to riches. Compounding is the safe road, the sure road, and happily, anybody can do it. To compound successfully, you need the following: **Perseverance** in order to keep you firmly on the saving path. You need **intelligence** so that you can fully understand what you are doing and why. You need a **knowledge** of the compounding tables in order to understand the amazing rewards that will come to you if you faithfully follow the compounding process. And one more requisite -- you need **time,** time to allow the power of compounding to work for you. Remember, compounding **only works through time**. Of course, the younger you are, the more advantageous the whole concept of compounding becomes.

Ah, but there are two catches in the compounding process. The first is obvious -- compounding may entail sacrifice -- the sacrifice is that you can't save it if you insist on spending it. The second catch is that compounding is boring, b-o-r-i-n-g. Wait, correction, compounding is boring until (after seven or eight years) the money starts pouring in. Then, believe me, compounding becomes very interesting. In fact, it becomes downright fascinating.

In order to emphasize the power of compounding, I am including this extraordinary study, courtesy of *Market Logic* [(800)442-9000]. In this study we assume that investor **(B)** opens an IRA at age 19. For seven consecutive periods he puts $2,000 in his IRA at an average growth rate of 10% (7% interest plus growth). After seven years he makes **no more** payments. He's finished.

A second investor **(A)** makes no contributions until age 26 (this is the age when investor **B** was finished with his contributions). Then **A** continues faithfully to contribute $2,000 every year until age 65 (at the same theoretical 10% rate).

Now study the incredible results. **B**, who made his contributions earlier, and who made only seven contributions, ends up with **more** money than **A**, who made 40 contributions but at a **later time.** The difference in the two is that **B** had seven more years of compounding than **A**. Those seven years were worth more than all of **A**'s 33 additional contributions.

This is a study that I suggest you show to your kids. It's a study that I, personally, have lived by, and I can tell you, "It works." You can do your compounding with top-grade muni bonds, T-bills or notes or a good money market fund. Then as the money comes in, you can diversify (if you wish) into top-grade stocks, all of which must pay dividends and preferably dividends of 5% or more. **Remember, you can not compound unless the items you invest in pay dividends or interest.**

Corollary: If you buy a stock that pays no dividend or even a very small dividend, you're in the position of hoping that the stock will rise. And I don't like being in a position of hoping. So remember, without a dividend, the stock you buy, unless it is advancing, is simply tying up capital without providing any benefit.

Rule 2: Don't Lose Money: This may sound like a naïve rule, but I assure you that it isn't. If you want to be wealthy, you must not lose money, or I should say, you must not lose BIG money. Absurd rule, silly rule? Maybe, but **most people lose money** in disastrous investments and stupid speculations. Yes, after five decades of investing and talking to investors, I can tell you that most people most definitely DO lose big money. They lose big-time in stocks, options, futures, real estate, bad loans, mindless gambling, worthless rumors -- and yes, in their own business.

	INVESTOR A		INVESTOR B	
Age	Contri-bution	Year-End Value	Contri-bution	Year-End Value
8	-0-	-0-	-0-	-0-
9	-0-	-0-	-0-	-0-
10	-0-	-0-	-0-	-0-
11	-0-	-0-	-0-	-0-
12	-0-	-0-	-0-	-0-
13	-0-	-0-	-0-	-0-
14	-0-	-0-	-0-	-0-
15	-0-	-0-	-0-	-0-
16	-0-	-0-	-0-	-0-
17	-0-	-0-	-0-	-0-
18	-0-	-0-	-0-	-0-
19	-0-	-0-	2,000	2,200
20	-0-	-0-	2,000	4,620
21	-0-	-0-	2,000	7,282
22	-0-	-0-	2,000	10,210
23	-0-	-0-	2,000	13,431
24	-0-	-0-	2,000	16,974
25	-0-	-0-	2,000	20,872
26	2,000	2,200	-0-	22,959
27	2,000	4,620	-0-	25,255
28	2,000	7,282	-0-	27,780
29	2,000	10,210	-0-	30,558
30	2,000	13,431	-0-	33,614
31	2,000	16,974	-0-	36,976
32	2,000	20,872	-0-	40,673
33	2,000	25,159	-0-	44,741
34	2,000	29,875	-0-	49,215
35	2,000	35,062	-0-	54,136
36	2,000	40,769	-0-	59,550
37	2,000	47,045	-0-	65,505
38	2,000	53,950	-0-	72,055
39	2,000	61,545	-0-	79,261
40	2,000	69,899	-0-	87,187
41	2,000	79,089	-0-	95,905
42	2,000	89,198	-0-	105,496
43	2,000	100,318	-0-	116,045
44	2,000	112,550	-0-	127,650
45	2,000	126,005	-0-	140,415
46	2,000	140,805	-0-	154,456
47	2,000	157,086	-0-	169,902
48	2,000	174,995	-0-	186,892
49	2,000	194,694	-0-	205,581
50	2,000	216,364	-0-	226,140
51	2,000	240,200	-0-	248,754
52	2,000	266,420	-0-	273,629
53	2,000	295,262	-0-	300,992
54	2,000	326,988	-0-	331,091
55	2,000	361,887	-0-	364,200
56	2,000	400,276	-0-	400,620
57	2,000	442,503	-0-	440,682
58	2,000	488,953	-0-	484,750
59	2,000	540,049	-0-	533,225
60	2,000	596,254	-0-	586,548
61	2,000	658,079	-0-	645,203
62	2,000	726,087	-0-	709,723
63	2,000	800,896	-0-	780,695
64	2,000	883,185	-0-	858,765
65	2,000	973,704	-0-	944,641
Less Total Invested:		(80,000)		(14,000)
Equals Net Earnings:		893,704		930,641
Money Grew:		11-fold		66-fold

Rule 3: Rich Man, Poor Man: In the investment world the wealthy investor possesses one major advantage over the "little guy," the stock market amateur and the neophyte trader. The advantage the wealthy investor enjoys is that **HE DOESN'T NEED THE MARKETS**. I can't begin to tell you what a difference that makes, both in one's mental attitude and in the way one actually handles one's money.

The wealthy investor doesn't need the markets, because he **already has all the income he needs.** He has the money coming in via bonds, T-bills, money market funds, stocks, and real estate. In other words, the wealthy investor **never feels pressured to make money in the market.**

The wealthy investor tends to be an **expert on values.** When bonds are cheap and bond yields are irresistibly high, he buys bonds. When stocks are on the bargain table and stock yields are attractive, he buys stocks. When real estate is a great value, he

buys income-producing real estate. When great art or fine jewelry or gold is on the "give-away" table, he buys art or jewelry or gold. In other words, the wealthy investor puts his money where the great values are.

And if no great values are available, the wealthy investor **waits.** He can afford to wait, because he has money coming in daily, weekly, monthly. The wealthy investor knows what he wants, knows what he's looking for, and he doesn't mind waiting months or even years for his next "bargain investment" (they call that **patience!**).

But what about the little guy? This fellow always feels pressured to "make money." And in return he's always pressuring the market to "do something" for him. But sadly, the market isn't interested. When the little guy isn't buying stocks offering 1% or 2% yields, he's off to Las Vegas or Atlantic City trying to beat the house at roulette. Or he's spending 20 bucks a week on lottery tickets, or he's "investing" in some crackpot scheme that his neighbor told him about (in strictest confidence, of course).

And because the little guy is trying to force the market to do something for him, he's a guaranteed loser. The little guy doesn't understand values so he constantly over-pays. He doesn't comprehend the power of compounding, and he doesn't understand money. He's never heard the adage, *"He who understands interest -- earns it. He who doesn't understand interest -- pays it."* The little guy is the typical American, and he's deeply in debt.

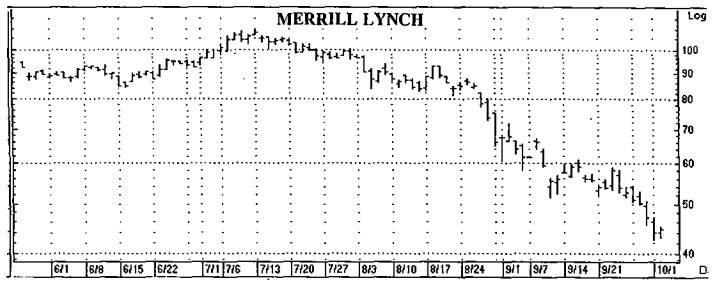
The little guy is in hock up to his ears. As a result, he's always sweating -- sweating to make payments on his house, his refrigerator, his car or his lawn mower. He's impatient, and he feels perpetually put upon. He tells himself that he has to make money -- fast. And he dreams of "the monster play and those big, juicy mega-bucks." In the end, the little guy wastes his money in the market, or he loses his money gambling, or he dribbles it away on senseless schemes. In short, this "money-nerd" spends his life dashing up the financial down-escalator.

But here's the ironic part of it. If, from the beginning, the little guy had adopted a strict policy of never spending more than he made, if he had taken his extra savings and compounded it in intelligent, income-producing securities, then in due time he'd have money coming in daily, weekly, monthly, just like the rich man. The little guy would have become a financial winner, instead of a pathetic loser.

RULE 4: VALUES: The only time the average investor should stray outside the basic compounding system is when a given market offers outstanding value. I judge an investment to be a great value when it offers **(a)** outstanding safety, **(b)** an attractive return, and **(c)** a good chance of appreciating in price. At all other times, the compounding route is safer and probably a lot more profitable, at least in the long run.

Comment: Compounding (which is what I advocate) is the exact **opposite** of gambling (excuse me, gaming), which I detest. If you gamble over any length of time you will end up a guaranteed loser, since the odds are always fixed in favor of the house. If you compound over a reasonable length of time (using the rules outlined above) you will almost surely be a winner. Gambling is a product of misguided emotions, wrong thinking or both. Compounding is a product of emotions under control and correct thinking -- resulting in the odds being definitely in your favor.

NOTES & QUOTES: Veteran subscribers know that I put a lot of emphasis on the action of the brokerage stocks. Wall Street is highly sensitive to forthcoming business, both in the economy and in terms of the volume of security transactions. I also concentrate on the largest of the Wall Street entities, Merrill Lynch. The collapse of this stock from its July 13 high of 109 to last week's low of 43 is almost shocking. This is a loss of 60%



in a period of two months. What is this collapse telling us? I think it's telling us that 1999 is going to be one tough year with probably a recession creeping in. Incidentally, with electronic trading coming in big time and with the volume of transactions due to contract, this is **not** a good time to go into the brokerage business (sorry, I realize that I have hundreds of broker-subscribers -- but you lads and ladies are paying me to tell it as I see it, not tell it to make you feel good).

* *

One year ago the IMF forecast that the global economy would expand by 4.3% this year, in line with the long-term growth trend of the last 25 years. But change: In a report last week the IMF announced that worldwide economic turmoil has cost millions of jobs and more than $600 billion in output. The agency (oops) also stated the global recession cannot be ruled out.

* *

"No Good Deed Goes Unpunished" Dept. Ah, the irony, Helmut Kohl, who almost single-handedly reunited East and West Germany, has been defeated after 16 years in office. Defeated by what? By the East German vote (the East Germans, suffering under an unemployment rate of 17%, were the swing vote that ousted Kohl).

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Bailouts are the order of the day, and I wrote long ago that when the next bear market arrives the Fed and the Administration will "fight the bear tooth and nail." Bailouts are simply part of that fight. Lowering interest rates and booming the money supply is another part of the government's fight. But all the government's interventions will have the effect of merely **extending and prolonging the bear market.** In the end the bear will have his way, and (don't tell the government this) the primary trend is more powerful than the President, the Congress and the Treasury all taken together.

As for the collapse of Long Term Capital Management, you may think that all is now well, but James Cramer (www.theStreet.com), a hedge fund manager, says differently: "There is no 'bail-out' of Long Term Capital. The principals will have nothing except for what they have hidden. They will be more than wiped out, they will owe huge when this is over. Stop buying that rap that they are being bailed out. They will be penniless. All of the money they managed will be lost, and chances are all of the people who had money in the fund will owe more money . . . Ask these jokers how you would value their portfolio if they had to sell it. BECAUSE THEY HAVE TO. Hint: not the bid side but the bid . . . Stop allowing these guys to be quoted like 'we are back in business,' or 'we will be roaring back.' They are history . . . Cover this story the way it should be: It is a disaster for the brokerage industry." **Russell Comment:** According to an article in the *NY Times,* an investor who put the minimum of $10 million in the fund now has roughly $400,000 . . . It turns out the Warren Buffett made an offer to buy Long Term Capital, but his offer was turned down. What does Buffett care? He's a master of patience. Buffett admits that he's having trouble finding any values today. So he'll wait. Patience, that's what Buffett has always had -- lots of patience.

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Japanese, French and German banks were the ones on the hook during the meltdown in Asia, S. Korea and Russia. US exposure was really light. But it's a different story in South America where US banks have major exposure in Brazil and other S. American nations. The rumor is that Brazil has been spending $1 billion a day to stabilize the real and keep Brazil's creditors from

panicking. A Brazilian collapse would shake the world and hit Wall Street like a cyclone. So as this is written, all eyes are on Brazil. If Brazil folds, watch out.

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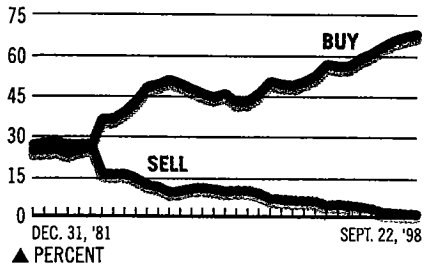
Perma-bulls: Wall Street analysts have literally forgotten how to say "sell." This chart from *Business Week* (Oct. 5) shows that sell recommendations have now dropped to a tiny 1.4% of all recommendations, while buy recommendations are still soaring.



BUY= PERCENTAGE OF ANALYST RECOMMENDATIONS TO BUY A STOCK
SELL= PERCENTAGE OF ANALYST RECOMMENDATIONS TO SELL A STOCK
THE REMAINING PERCENTAGE IS A RECOMMENDATION TO HOLD

* *

The rumor is that Treasury Secretary Robert Rubin would love to say "bye-bye" to Washington and the Clinton Administration. The problem is that if he quit now it would look as if he was leaving a sinking ship. It's always hard to recruit people during the tail-end of a presidency, but for a failing presidency it's almost impossible. It's interesting but so far Clinton has been unable to get any big name to represent him in any impeachment proceedings.

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San Diegans: Finally, there's a physician who does **chelation** in La Jolla. Call (619)456-1996.

* *

A major problem for Japan is that its leaders and politicians are doing all they can to hide the problem of the banks instead of solving the problem. Of course, the problem is that many of the banks are technically insolvent, but instead of letting nature take its course, the Japanese leaders have become part of the problem. The basis of this could be the Japanese famous habit of refusing to lose face.

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Goldman Sachs canceled the much anticipated public offering of their stocks, originally scheduled for October or early November. Evidently, the guys at Goldman are not listening to Abby Cohen, who has been saying that the Dow should be around 9300 by year-end '99. On top of that, S&P changed Goldman's credit rating from stable to negative, based on slackening underwriting business and volatile markets ahead.

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The Sept. 24 *NY Times* included an article on Manhattan real estate. "Hundreds of sellers of co-ops and condos dropped their prices last week, said the heads of two of Manhattan's best-known real estate companies . . . Hal Wilkie at Brown Harris said, 'And there are a lot of sellers asking, 'Am I going to get less than a month ago?' I tell them it'll be more difficult to sell; it will depend on what happens on Wall Street two months from now. And whatever it is, it'll have a major impact on our market.'"

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The coming battle of the dollar vs. the euro is going to be a biggie. One fear is that when the euro comes into being it will expose a lot of weakness behind the dollar, for instance, the US' status as the world's biggest debtor and our continuing huge negative trade balance. Nevertheless, at present, the world wants dollars. The Fed estimates that of the $443 billion in US currency in circulation, roughly two-thirds are held offshore. By not having to borrow and pay interest on that money, the US Treasury saves $15 to $18 billion a year.

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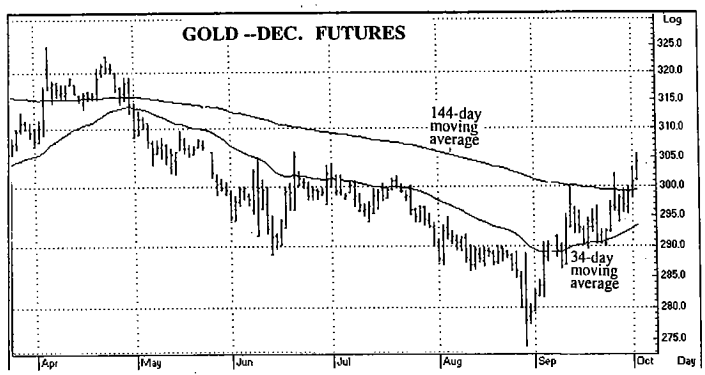
Clinton is grasping at a final, desperate clincher for his failed tenure in office . . . Washington had the Revolution, Lincoln had the Civil War, FDR had World War II, Truman had the Marshall Plan, Clinton has -- sleaze, perjury and sex in the Oval Office. But wait, he's telling us repeatedly that we are now facing "the worst world emergency in 50 years." Ah, a marvelous opportunity for Clinton. The President to the fore; he's selling us his new world economic architecture. G-7, with Clinton at the helm, will save the world, as we know it. Will it work? My guess -- no, not with this damaged, lame-duck president at the helm. Not with a Republican Congress that is more interested in destroying him than helping him. The bear will have his way.

GOLD: The money supply is booming, which **is monetary inflation** -- normally a strong bullish force for higher gold prices. On top of that, the world currency markets are in a state of chaos; nobody knows which currency is going take the fall next, although all eyes are on Brazil's real. Gold can't be destroyed by horrendous trade balances or fumbling politicians or manipulating IMF economists. Gold has been money for thousands of years and it's still money, no matter what young Harvard-educated central bankers tell you.

I'm reasonably confident that we've finally seen the final lows for gold. If I'm right, that implies that gold and gold shares, after 18 years, are finally in a new primary bull market. If I'm right, then one way or another, gold will be pushing higher. As I said in the last few Letters, this is a good time to take initial positions in a few of the leading gold shares -- Barrick Resources, Newmont Mining, Newmont Gold, Homestake. Remember, at the beginning of a new bull market the price action tends to be erratic, exasperating, confusing (it's the same erratic kind of action we see at the start of a new bear market). After all, following 18 years of discouraging bear market action, you'd hardly expect investors to go wild over gold six weeks off the bottom. It takes TIME.

The price structure for gold has the look of a bottom. On October 1 the December gold contract broke out above its long-term or 144-day moving average. So technically, finally, the gold picture looks bullish. The first phase of the new bull market is now in progress.



LATE NOTES: A subscriber called and asked me, " Russell, you're honest opinion -- what do you think is happening?" I told him, "We're in a bear market." On October 1 the D-J Transportation Average broke to new bear market low of 2562.05. As this is written, the Transports are sinking to new lows. The Transports have been the bellwether leaders in this bear market so far. It remains for the Dow to either resist, or follow the Transports to new lows (the Dow low was 7539.07). Historically, when one Average breaks to new lows in the primary direction, the other (in this case the Dow) usually follows. If the Dow breaks 7539.07, a new down-leg of the bear market will be underway. **NEXT MAILING : Oct. 21, 1998.**